John Ensign, Chairman
Pamela Thiessen, Staff Director

347 Russell Senate Office Building
Washington, DC 20510
202-224-2946
http://rpc.senate.gov

U.S. SENATE REPUBLICAN POLICY COMMITTEE

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A Government-Run "Public" Health Insurance Plan: Why Doctors, Hospitals, and Patients Will Lose

Executive Summary

- One of the most controversial proposals for health care reform is the creation of a new government-run "public" health insurance plan that would compete against private insurers like Blue Cross Blue Shield. Creating a new government-run plan will have dangerous consequences for doctors, hospitals, and Americans with private health insurance.

- By creating a new government-run plan, independent estimates show that 118 million Americans (nearly 6 out of every 10 Americans with private coverage) could lose their current health care coverage, and 130 million Americans could end up on a government-run health insurance plan.

- A government-run plan will drive the cost of private health care up, not down. Expansion of government-run programs will exacerbate the cost-shift that already drives up average health care spending by $1,788 (or 10.7 percent) annually per family.

- Doctors and hospitals could experience significant payment cuts under a new government-run plan. Because of these cuts, Americans on the government-run plan will find it more and more difficult to make appointments with physicians and other health care providers because lower payments will make it increasingly unaffordable for them to see patients.

- Rather than pushing the health care system to adopt the best practices of the private sector—like promoting wellness—expanding government-run health insurance plans would encourage the outdated Medicare and Medicaid delivery system. Government-run programs like Medicare and Medicaid are characterized by unnecessary waste and outmoded benefit design. While private plans are demonstrating models of coordinated and integrated care that promote higher value health care, Medicare still relies on an outmoded delivery model.

- The way to improve the health care system is to promote real competition among private plans to make them demonstrate effectiveness and compete on quality and cost.

Introduction:

There is a broad agreement among policymakers on the need to reform our health care system to make it more affordable, improve the quality of care, and expand access to all Americans. However, certain proposals raise such serious policy concerns that they would almost certainly undermine the chances for bipartisan support.

One of the most controversial proposals for health care reform is the creation of a new government-run "public" health insurance plan. The new government-run plan would compete against private insurers like Blue Cross Blue Shield. Designed to sound innocuous, the government-run plan option is the Trojan horse in health care reform. Advocates of a single payer system have stridently argued for its inclusion in a health care reform proposal because they understand that a government-run plan is the gateway to a government-run system. These advocates know that the government-run plan would have an unfair advantage over private sector plans because Congress will give it the power to dictate prices and indemnify the government-run plan for unexpected costs. This would guarantee, at least temporarily, that the government-run plan would offer insurance at below-market costs. Inevitably, the government-run plan will take over the market for health insurance, leaving room for only the government-run plan making health care decisions dictated from Washington.

Creating a new government-run plan will have dangerous consequences for doctors, hospitals, and Americans with private health insurance. Independent estimates show that 118 million Americans (nearly 6 out of every 10 Americans with private coverage) could lose their current health care coverage, and 130 million Americans could end up on a government-run health care plan if the government sets payment rates at Medicare rates.[1] Expansion of government-run programs will also exacerbate the cost-shift that already drives up average health care spending by $1,788 (or 10.7 percent) annually per family.[2] The government-run plan would exacerbate the cost shift because when government payment rates are too low, providers shift costs to private payers to make up the difference.

Existing public plans provide less coverage and restrict provider access more than the average employer-sponsored plan. The Congressional Budget Office (CBO) estimated that the benefit package for Medicare is 15 percent below the average employer-sponsored plan.[3] Under Medicaid, specialists are often inaccessible without long waits.[4] Under a new government-run plan, Americans will find it more and more difficult to make appointments with physicians and other health care providers. This is because lower payments will make it increasingly unaffordable for providers to see patients—particularly the increasing number of patients with public coverage.

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[1] Lewin Group, Enrollment in Public Plan under Obama Proposal under Alternative Scenarios, 2008. Available at: http://www.lewin.com/content/publications/OpeningBuyInPublicPlan.pdf.
[2] Milliman, "Hospital and Physician Cost Shift Payment Level Comparison of Medicare, Medicaid, and Commercial Payers," December, 2008.
[3] Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December, 2008.
[4] *Wall Street Journal*, "Note to Medicaid Patients: The Doctor Won't See You," July 19, 2007.

Moreover, creating a new government-run plan based on Medicare or Medicaid would take us in the wrong direction and represent a step backwards for modernizing health care delivery. Members of Congress do not have access to a special government-run plan, and the Massachusetts health care reform effort did not include a new government-run health insurance option. Rather than pushing the health care system to adopt the best practices of the private sector—like promoting wellness by providing financial incentives for healthy behaviors—expanding government-run plans would encourage a delivery system characterized by unnecessary waste and outmoded benefit design.

While some promote a new government-run option as an innocuous additional choice, it will have dramatic consequences for patients, doctors, hospitals and other health care providers. This analysis will explain the dangers inherent in creating a new government-run plan and why it must not be a part of health care reform.

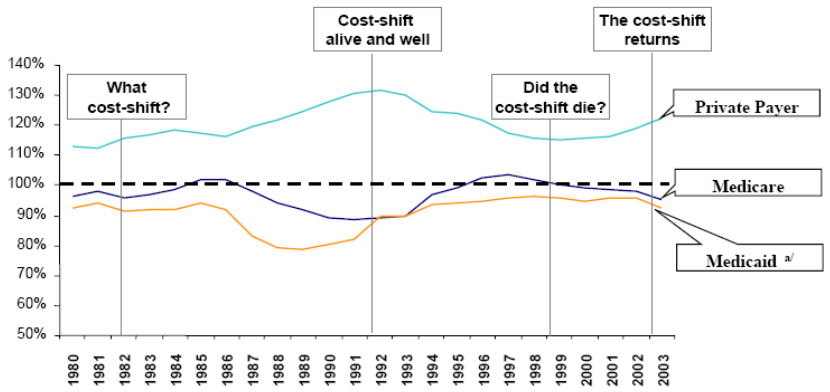
A government-run plan will drive the cost of private health care up, not down:

Cost-shifting from Medicare and Medicaid to private health care plans is one of the most important but understated drivers of health care costs.[5] In effect, people with private insurance pay a hidden "tax" to support the health care of people using government-run programs like Medicare and Medicaid.[6] With a government-run plan, the government uses its power to set payment levels in public programs at rates below what the market would otherwise demand. To make up for lost revenues, providers shift costs to private payers in the form of higher charges. A new government-run health insurance option would exacerbate the cost-shift and drive *up* the cost of health care. The chart below shows how decreased public plan reimbursements lead to increased costs to private payers.

[5] "The concept of the 'cost-shift payment hydraulic' is remarkably simple; as some pay less, others must pay more." Allen Dobson, Joan DaVanzo, and Namrata Sen, *Health Affairs*, "The Cost-Shift Payment 'Hydraulic': Foundation, History, And Implications," Jan/Feb 2006.

[6] Daniel P. Kessler, Stanford University Graduate School of Business, "Cost Shifting in California Hospitals, What is the Effect on Private Payers?" June 6, 2007.

Aggregate Hospital Payment-to-Cost Ratios for Private Payers, Medicare and Medicaid 1980-2003



Source: Lewin Group[7]

A report by the actuary Milliman estimated the "hidden tax" commercial payers pay to subsidize the costs of Medicare and Medicaid at $88.8 billion per year.[8] This means that average health care spending is $1,788 (or 10.7 percent) more annually per family than it would be without the cost-shift.[9] This study is critical to understanding the impact of any proposed expansion of entitlement programs or the addition of a new government-run plan option to a health insurance exchange or connector. The Milliman study demonstrates that creating a new government-run plan would significantly *increase* the cost of private health insurance.

Ironically, proponents of universal coverage ignore the cost-shift between public and private plans even as they argue that the costs for uncompensated care drive up health care costs. These advocates argue that we can pay for health care reform by insuring everyone because it would eliminate the cost of providing uncompensated care. While insuring everyone has obvious merits, it will not pay for itself. As Harvard Professor Kate Baicker wrote, empirical research "demonstrates that insured people use more care (and have better health outcomes) than uninsured people do—so universal insurance is likely to increase, not reduce, overall health spending."[10] Moreover, Stanford Professor Daniel Kessler studied California hospitals and

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[7] Lewin Group, Presentation to the Conference on the Future of Hospital Payments, "The Foundation, History and Implications of the Cost-Shift Hydraulic," July 15, 2005. Available at: http://www.fah.org/fahCMS/Documents/Future%20of%20Hospital%20Care/Dobson%20slides%207.7.05%20History%20and%20Foundation%20of%20the%20Cost-Shift.pdf.

[8] Milliman, "Hospital and Physician Cost Shift Payment Level Comparison of Medicare, Medicaid, and Commercial Payers," December, 2008.

[9] Milliman, "Hospital and Physician Cost Shift Payment Level Comparison of Medicare, Medicaid, and Commercial Payers," December, 2008.

[10] Katherine Baicker and Amitabh Chandra, *Health Affairs*, "Myths And Misconceptions about U.S. Health Insurance," October 2008.

found that cost-shifting from the uninsured has "minimal" impact on costs, while cost-shifting from public programs has a "substantial" impact.[11] Specifically, cost shifting from public programs increased hospital revenue-to-cost ratios for private payers by 10.8 percent, while cost shifting from the uninsured increased the revenue-to-cost ratio by only 1.4 percent.[12]

The challenges could be even more severe for hospitals which serve lower-income communities. These hospitals would have a higher proportion of patients paying public program rates. They also would have a harder time passing costs on to private payers both because private payers would represent a smaller portion of their caseload and because those patients who did have private insurance would likely be lower-income and more cost sensitive.[13]

Including a government-run plan will force Americans out of their current health care coverage and into a government-run plan:

The real danger behind a government-run health insurance plan is that it will force people off of their current private health insurance plan. President Obama repeatedly promised that if Americans liked the health insurance they had, they could keep it.[14] According to independent estimates, creating a government-run plan would undermine this promise. Because the government-run plan will shift costs to the private market and have unfair advantages over existing plans, the Lewin Group found that 118 million Americans could lose their current health care coverage, and 130 million Americans could end up on a government-run health care plan.[15] Because the federal government will act as a competitor, a regulator, and a funder, the government-run plan option will ultimately force private insurers out of business. As the *Wall Street Journal* wrote, "Because the public option will enjoy taxpayer sponsorship, it will offer generous packages to consumers that no private company could ever afford or justify. And because federal officials will run not only the new plan but also the 'market' in which it 'competes' with private programs—like playing both umpire and one of the teams on the field—they will crowd out private alternatives and gradually assume a health-care monopoly."[16]

Importantly, the cost-shift from the government-run plan to the private plan will create a self-reinforcing cycle that will eventually lead to a government-run single payer health care plan. The reasoning is simple. As the government-run plan grows and cost shifts more and more to private plans, the price differential between the two types of plans will increase. This self-reinforcing cycle will make the government-run plan increasingly the only viable option. This cycle will force employers to put their employees on the government-run plan in order to avoid the higher cost of private insurance. Tying the government-run plan to a "pay-or-play" mandate,

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[11] Daniel P. Kessler, Stanford University Graduate School of Business, "Cost Shifting in California Hospitals, What is the Effect on Private Payers?" June 6, 2007.
[12] Daniel P. Kessler, Stanford University Graduate School of Business, "Cost Shifting in California Hospitals, What is the Effect on Private Payers?" June 6, 2007.
[13] An argument could be made that these hospitals would see increased revenues because the number of patients receiving uncompensated care would decrease. However, these hospitals currently receive Disproportionate Share Hospital (DSH) payments to help make up for uncompensated care. These DSH payments would likely be redirected with a transition to universal care, as Massachusetts has done with its health reform plan.
[14] "If you like the insurance you have now, nothing will change under the Obama plan, except that you will pay less." Obama '08 Campaign, Background Questions and Answers on Health Care Plan.
[15] Lewin Group, Enrollment in Public Plan Under Obama Proposal Under Alternative Scenarios, 2008.
[16] *Wall Street Journal*, "The Obama Health Plan Emerges," November 20, 2008.

Lewin says, "[M]ore and more employers will cover their workers [under the government-run plan] over time as the payroll tax will become an increasingly better deal because the rate of increase in wages and the payroll tax rate will be less than the projected increases in private insurance premiums."[17]

The end result will be a health care system dominated by a single government-run health insurance plan, with a residual private market only for the wealthy willing to pay more to maintain access to the health care services that they currently enjoy. If this choice was presented to the American public, it would be uniformly rejected.[18] That is why supporters of a single-payer system are relying on the government-run plan option to hide their real intent. If Americans understood the consequences of a government-run plan, they would reject it with the same resolve that they reject government-run health care.

Doctors and hospitals will be hurt by a government-run plan:

Contrary to rhetoric used by supporters of a government-run plan, the government does not use its leverage to "bargain" with providers to set payments.[19] Instead, supporters of a government-run plan want the government to use its authority to administratively set payment rates for providers below what the market would support. The Congressional Budget Office (CBO) confirms that the government does not "bargain" with providers, writing that, "Fee-for-service payment rates in Medicare and Medicaid are <u>set administratively</u>."[20] (emphasis added). A new government-run plan "would compete against privately run plans and <u>could use administered pricing</u> to set its payment rates."[21] (emphasis added). Experience shows that as health care costs rise, provider payment rates are one of the first targets for cuts. The temptation to cut provider rates would be even greater as the government assumes more costs for subsidizing the uninsured.

If history is any guide, the payment rates set by a new government-run plan would be far below private market rates. CBO explained the significant gap between private and public providers:

> "On average, payment rates under Medicare and Medicaid are lower than private payment rates. *Specifically, Medicare's payment rates for physicians in 2006 were nearly 20 percent lower than private rates, on average, and its payment rates for hospitals were as much as 30 percent lower. As for Medicaid, recent studies indicate that its payment rates for physicians and hospitals were about 40 percent and 35 percent*

[17] The Lewin Group, Cost Impact Analysis for the "Health Care for America" Proposal, Feb. 15, 2008.
[18] By a 61-20 margin, Americans believe the private market will deliver better health care than the government. Coalition to Advance Health Care Reform Poll, Conducted August 18-22, 2008.
[19] This argument has recently been made in a widely publicized article by Berkeley Law Professor Jacob Hacker, which praised the gap between private payment rates and public payment rates as proof of Medicare's "bargaining power." Prof. Hacker writes that, "It is worth remembering, after all, that price bargaining is exactly what HMOs and other big health plans were supposed to do—only Medicare appears to do it better." (Jacob Hacker, "The Case for Public Plan Choice in National Health Reform," December, 2008). Of course, there is an obvious difference between the government administratively setting prices and the type of bargaining that private health plans conduct with provider networks.
[20] Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December, 2008.
[21] Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December, 2008.

> *lower, respectively, than private rates*. … Given those differences, proposals that shifted enrollment between private and public plans could have a large impact on payments to providers and on spending for health care. Depending on how providers responded to those changes, *enrollees' access to care could be affected*."[22] (emphasis added)

If doctors and hospitals are forced to accept Medicare payment rates in a new government-run plan, they would experience significant revenue loss. Physicians, who increasingly cannot afford to accept public plan reimbursement rates to treat patients, would see their revenues decline by $36.4 billion (6.8 percent).[23] Hospitals would see revenues decline by $36.5 billion (4.6 percent).[24]

Again, this underpayment leads to a cost-shift. The Milliman actuaries explained how doctors and physicians are underpaid by public plans and try to make up the difference by overcharging private payers.

> "[W]hile hospitals posted a 3.8% overall operating margin in 2006, it was composed of a 23.1% margin on commercial payers offsetting large losses on public payers and self pay. … [For doctors] Medicare payment rates are approximately 89% of the overall average rate for these three payer types. Medicaid rates are approximately 60% of the overall average, and commercial rates are approximately 114% of the average. For the same service, then, Medicare would pay 11% less than average, Medicaid would pay 40% less than average, and commercial payers would pay 14% more than average."[25]

Many doctors are already refusing to see Medicaid patients because payment rates will not even cover costs.[26] Faced with increased cost pressure from a government-run plan, doctors would likely be forced to limit access to even more patients. To increase their revenues, doctors would have no choice but to change their practice patterns and spend even less time with patients, and hospitals would have to cut back on many new treatments and technologies.[27] The government-run plan could therefore have very negative consequences on the quality of care that Americans expect from their health care system.

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[22] Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December, 2008.
[23] Lewin Group, Enrollment in Public Plan under Obama Proposal under Alternative Scenarios, 2008. Lewin estimated that hospital payment levels would decrease by 26 percent and physician payment levels would decrease by 17 percent for enrollees in a Medicare-like public plan who previously had private coverage. Lewin Group, Cost Impact Analysis for the "Health Care for America" Proposal, February 15, 2008. Available at: http://www.sharedprosperity.org/hcfa/lewin.pdf
[24] Lewin Group, Enrollment in Public Plan under Obama Proposal under Alternative Scenarios, 2008.
[25] Milliman, "Hospital and Physician Cost Shift Payment Level Comparison of Medicare, Medicaid, and Commercial Payers," December, 2008.
[26] *See Wall Street Journal*, "Note to Medicaid Patients: The Doctor Won't See You," July 19, 2007.
[27] "As public payers pay less, the financial pressure on hospitals renders them less capable, not only for the uninsured and public beneficiaries, but for all those who use and expect a high level of hospital services." *Health Affairs*, Allen Dobson, Joan DaVanzo, and Namrata Sen, "The Cost-Shift Payment 'Hydraulic': Foundation, History, and Implications," Jan/Feb 2006.

Supporters of a government-run plan overstate administrative costs of private plans:

Opponents of the private market in health care often cite the administrative costs of private plans as a reason to expand government-run plans. However, these claims often overstate actual administrative costs for private plans while understating them for government-run plans. The American Medical Association (AMA) wrote, "The AMA believes that usual methods of estimating administrative costs ignore important facts, thereby overstating differences between private and public insurance, and that administrative costs are actually lower than generally reported in the private sector and higher than generally reported in the public sector."[28]

The Baucus White Paper on health care reform, for example, claims that administrative expenses for coverage purchased in the private insurance market represent 22 percent of the cost of private insurance.[29] However, CBO recently reported that administrative costs for larger employment-based plans (which are the most comparable to Medicare) are only around 7 percent.[30] Government-run plans like Medicare would have much greater administrative expenses if they competed in the same market as private health insurance. A government-run plan like Medicare does not have to comply with varying state insurance regulations nor does it have to underwrite applications because Medicare is open to all seniors at the same cost.[31] Reforming the insurance market could significantly reduce administrative costs for private plans.

Additionally, administrative costs cover important services like disease management programs and research to determine which interventions actually work.[32] It is ironic that the same advocates who frequently cite the need for the government to spend billions in taxpayer dollars to improve health outcomes are the same who decry the high administrative costs in health care plans. As Ezekiel Emanuel, an adviser to President Obama on health care (and brother of White House Chief of Staff Rahm Emanuel), wrote, "The idea that we could wring billions of dollars in savings [from cutting administrative costs] is seductive, but it wouldn't really accomplish that much. For one thing, some administrative costs are not only necessary but beneficial. Following heart-attack or cancer patients to see which interventions work best is an administrative cost, but it's also invaluable if you want to improve care."[33] Additionally, Medicare loses untold billions to Medicare fraud each year due to inadequate scrutiny of claims.[34] While private health providers pay (out of administrative costs) for programs to keep fraud to a minimum, the federal government invests little, and as a result taxpayers pay more.

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[28] American Medical Association, "Administrative Costs of Health Care Coverage," available at: http://www.voicefortheuninsured.org/pdf/admincosts.pdf.

[29] Senator Max Baucus, Senate Finance Committee, "Call to Action: Health Care Reform 2009," November 12, 2008.

[30] Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December, 2008.

[31] Additionally, while Medicare claims administrative costs of around 3 percent, the cost is closer to 6 percent when the administrative costs of other federal administrative functions are allocated proportionally. Manhattan Institute for Policy Research, "Comparing Public and Private Health Insurance," *Medical Progress Report No. 5*, October 2007.

[32] Merrill Mathews, PHD, "Medicare's Hidden Administrative Costs," Jan. 10, 2006.

[33] Ezekiel Emanuel and Shannon Brownlee, Op-Ed, *Washington Post*, "5 Myths on Our Sick Health Care System," November 23, 2008.

[34] "Law enforcement authorities estimate that health-care fraud costs taxpayers more than $60 billion each year." *Washington Post*, "Medical Fraud a Growing Problem," June 13, 2008.

A government-run plan would take us in the wrong direction:

While a government-run plan has become a central point of contention, experience shows that it is not necessary to reform the health care system. While most Americans would want access to the same kind of health care that members of Congress have, members of Congress don't have access to a special government-run plan—and don't need one. The Federal Employees Health Benefits Plan (FEHBP) provides member of Congress a broad range of private health insurance choices—from inexpensive plans with basic coverage to "Cadillac" plans. Additionally, the Massachusetts health care reform effort does not provide for a government-run health insurance option.[35] Allowing the government to compete against private plans would therefore represent a radical departure from current practices.

Additionally, a government-run plan based on Medicare would represent a step backwards for modernizing health care delivery. Rather than pushing the health care system to adopt the best practices of the private sector—like promoting wellness by providing financial incentives for healthy behaviors such as losing weight, and quitting smoking—expanding government-run plans would maintain the outdated Medicare and Medicaid delivery system. Government-run programs like Medicare and Medicaid are characterized by unnecessary waste and outmoded benefit design. While private plans are demonstrating models of coordinated and integrated care that promote higher value health care, Medicare still relies on an outmoded delivery model.

Additionally, benefits under existing public plans are below those offered on the private market. CBO found that overall, "the actuarial value of Medicare's benefits for the nonelderly population is about 15 percent lower than that of a typical employment-based plan."[36] And under Medicaid, patients often have difficulty finding providers to see them because of below-market reimbursements.[37] The way to improve the health care system is to promote real competition among private plans to make them demonstrate effectiveness and compete on quality and cost. We should reform the health system by promoting higher value health care rather than expanding government-run plans that restrain costs primarily by forcing providers to take below-market payments.

Conclusion:

Including a government-run plan in health care reform would have serious consequences for patients, providers, and the entire American health care system. Advocates for a single-payer system understand that the American people will not support a government-run health care system, so they are attempting to hide their intentions behind a new government-run "public" plan. Americans want a health care system that supports innovation, puts patients and doctors at

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[35] More than 30 state governments offer a self-insured health insurance plan that competes against traditional private health insurance plans. These self-insured plans are publicly owned and financed by the state governments, but run by private providers without using the government's power to set prices or control costs. Len Nichols and John Bertko, New America Foundation, "A Modest Proposal for a Competing Health Plan," March, 2009.

[36] For example, CBO notes that there is no annual limit on out-of-pocket costs under Medicare. Congressional Budget Office, "Key Issues in Analyzing Major Health Insurance Proposals," December, 2008.

[37] "Medicaid provides health-care coverage for millions of Americans -- but a growing number of doctors won't accept it." *Wall Street Journal*, "Note to Medicaid Patients: The Doctor Won't See You," July 19, 2007.

the center of health care decisions, and allows patients to choose the health care plan that best meets their needs. A government-run plan fails on each of these principles, and that is why it should not be considered as part of health care reform.